

# Tax Legislative Update

## Breaking news from Capitol Hill

### From Grant Thornton's Washington National Tax Office

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## Lawmakers agree on historic stimulus bill

Lawmakers are close to completing a massive stimulus package that will offer deep tax relief to both businesses and individuals. Republican and Democratic leaders negotiated the compromise bill together, and it is expected to be enacted despite some last minute disagreements over unemployment insurance. The tax title is largely settled but technical or other last-minute changes remain possible.

The bill is a \$2 trillion combination of both tax provisions and other stimulus measures, including emergency business lending. The tax package itself is broad, with payment tax relief, significant business tax incentives, several long-sought technical corrections to the Tax Cuts and Jobs Act (TCJA), and individual tax cuts and rebate checks. The business tax changes will allow for immediate refunds in many cases and should provide considerable cash flow relief. The most significant business provisions include:

- Allowing net operating losses (NOLs) arising in 2018, 2019 and 2020 to be carried back five years and suspending the 80% taxable income limit until 2021
- Increasing the taxable income threshold for the Section 163(j) limit on the interest deduction from 30% to 50% for tax years beginning in 2019 and 2020 and allowing taxpayers to use 2019 taxable income to calculate the 2020 limit
- Allowing corporations to claim refunds for all remaining AMT credits in 2018 and 2019
- Correcting an error in TCJA that prevented qualified improvement property (QIP) from qualifying for 100% bonus depreciation
- Suspending payment requirements for the 6.2% employer portion of Social Security taxes from the date of enactment through the end of 2020, with half the balance due by the end of 2021, and the other half due by the end of 2022
- Creating a new refundable employee retention credit of up to \$5,000 for paying wages while business operations are suspended, or if gross receipts for a business drop by 50%
- Increasing the taxable income limit on corporate charitable deductions from 10% to 25% and contributions of food inventory from 15% to 25%
- Suspending the limit on excess business loss deductions under Section 461(l) in 2018, 2019 and 2020 so that it takes effect for the first time in 2021

The final version of the legislation dropped provisions from the initial Senate Republican proposal that would have fixed TCJA issues on Section 965 overpayments and the downward attribution rules of former Section 958(b)(4). Lawmakers also removed a provision with statutory relief for certain tax filing and payment obligations, which would have potentially broadened the relief offered by the IRS so far.

The centerpiece of the individual tax title would offer rebate checks based on a new tax credit of \$1,200 per filing adult and \$500 for each qualifying child. The credit begins to phase out at an adjusted gross income (AGI) of \$75,000 (single), \$112,500 (head of household) or \$150,000 (joint), but it is made fully refundable in the final bill, unlike prior versions. Other provisions for individuals include:

- Waiving early withdrawal penalties for up to \$100,000 in COVID-19-related withdrawals from qualified retirement accounts, and allowing it to be paid back or included ratably in income over three years
- Doubling the amount taxpayers can borrow from certain qualified retirement accounts to \$100,000
- Suspending required minimum distributions for 2020
- Allowing an above-the-line deduction for up to \$300 in charitable contributions for taxpayers who do not itemize deductions in 2020
- Removing the AGI limit on individual itemized deductions for charitable contributions in 2020
- Excluding employer student loan repayment assistance of up to \$5,250 from income in 2020
- Permanently restoring the ability for taxpayers to use health savings accounts and flexible spending arrangements to purchase over-the-counter medicine

The bill would also suspend all aviation excise taxes and the fuel excise taxes on aviation kerosene from the date of enactment through the end of 2020 and provide an exception to alcohol excise taxes for alcohol used to make hand sanitizer.

## Impact

Many of the provisions will provide tremendous cash flow relief. The suspension of the employer portion of Social Security taxes is particularly powerful, and most of the other provisions are also designed to provide quick access to cash. Taxpayers will have various options for claiming many of the benefits, including amending 2018 returns, using 2019 returns, or filing for a tentative refund. Taxpayers should assess their options carefully before acting, as different filing positions can affect when a taxpayer receives a benefit and the ultimate size of the benefit. The following provides more details on the provisions.

## Business benefits

### NOL carrybacks

The legislation provides that NOLs arising in tax years beginning after Dec. 31, 2017, and ending before Jan. 1, 2021, can be carried back for five years. The limitation allowing NOLs arising in tax years beginning after 2017 to offset only 80% of taxable income will be temporarily suspended for tax years beginning before 2021. But when the suspension is lifted, the bill also codifies a less favorable application of the rules for stacking NOLs subject to the 80% limit with pre-TCJA NOLs that are not subject to the limit. The bill also fixes a technical error in TCJA that prevents NOLs arising in a tax year ending in 2018 from being carried back.

The NOL carrybacks will not be allowed to offset the Section 965 inclusion for the one-time repatriation tax. It appears the NOLs will still be allowed against other income in the inclusion year, but taxpayers will have the option to elect to forgo applying the carryback to that year.

**Grant Thornton Insight:** Lawmakers declined to add a “haircut” requiring corporate NOL carrybacks to be applied using the current 21% rate or to require individuals to use the current 37% rate. The ability to carry back current NOLs to pre-TCJA years will offer a tremendous opportunity for corporations to use deductions and losses against a 35% corporate rate. Accelerating deductions from a future year into a year allowing the carrybacks could result in a permanent benefit due to the difference between the 21% rate and 35% rate.

### **AMT credits**

The legislation allows corporations to immediately claim unused AMT credits. The TCJA had repealed the corporate AMT and provided that any unused AMT credits could be claimed as refundable credits over the four tax years beginning in 2018, 2019, 2020 and 2021. The legislation provides that the credits can be claimed fully in the tax years beginning in 2018 and 2019.

**Grant Thornton Insight:** Taxpayers should have already recovered 50% of their AMT credits during the tax year beginning in 2018. The mechanics of the statutory change will allow taxpayers to claim the remaining 50% on the 2019 return or to amend the 2018 return and claim the remaining 50% with a 2018 refund claim. The statute also provides for recovering the benefit using a tentative refund claim.

### **Interest limitation**

The legislation allows taxpayers to make an election to limit their deduction for net business interest under Section 163(j) to 50% of taxable income instead of 30% for tax years beginning in 2019 and 2020. Taxpayers can elect out of this treatment. In addition, the bill adds an election to allow taxpayers to use their taxable income for 2019 to calculate their limit for 2020. Both elections must be made at the partnership level. In addition, 50% of excess business interest allocated to a partner in the tax year beginning in 2019 will be reclassified as business interest expense and not subject to the limit at the partner level in 2020 unless the partner elects out.

**Grant Thornton Insight:** The IRS is very close to releasing final and proposed regulations under Section 163(j), which could also affect the calculation and should be factored into decisions on the elections.

### **QIP technical correction**

The legislation retroactively provides that QIP is eligible for bonus depreciation as if enacted originally in TCJA. An error in the legislative language of the TCJA omitted QIP from the list of 15-year property, meaning that it did not qualify for 100% bonus depreciation, and must be depreciated over 39 years. This change will reverse that error.

**Grant Thornton Insight:** The definition of QIP created by TCJA is incredibly broad and applies to almost any improvement to the interior of leased or owned space. It's particularly important to the retail and hospitality industries, but almost any business that makes building improvements will qualify. The change is made retroactive as if included in TCJA, so taxpayers will likely have the option of amending prior returns to claim the benefit or to take the benefit on their next return with an accounting method change.

### **Business loss limitation**

The legislation provides that the limit on deducting businesses losses in excess of \$250,000 (single) or \$500,000 (joint) under Section 461(l) would be temporarily repealed retroactive to 2018, not taking effect until 2021. The legislation clarifies some technical uncertainties, providing that NOLs themselves are not considered excess business losses and that employee wages are not used in the calculation. It also provides that business capital losses are not be included in the calculation so they will no longer be converted into future NOLs.

**Grant Thornton Insight:** Taxpayers may have filing options to claim the benefit of this change. Taxpayers could amend their 2018 returns to remove the limitation for that year, but the provision essentially creates a one-year deferral by turning the excess business loss into an NOL. This means taxpayers would also be in a position to simply use the NOL in the 2019 tax year. Whether this would be allowable is unclear considering that the provision that created the NOL was retroactively made inoperative.

### **Payroll tax relief**

The legislation allows employers to defer deposits of the 6.2% employer portion of the Social Security tax for Old Age, Survivors, and Disability Insurance (OASDI) from the date of enactment through the end of the year. Half of the deferred payment amount is due by Dec. 31, 2021, with the other half due by Dec. 31, 2022. Individuals paying self-employment tax are provided with equivalent relief.

**Grant Thornton Insight:** The combination of this statutory relief from payroll tax payment obligations and the IRS's recent administrative relief for income and estimated payments due on April 15 is almost unprecedented and will provide significant cash-flow flexibility.

### **Employee retention credit**

The legislation creates a 50% credit for paying up to \$10,000 in employee wages for a business that was fully or partially suspended due to a government order or that saw a 50% reduction in gross receipts for the first quarter beginning in calendar 2019 compared to the same quarter in the prior year. Wages remain eligible until business is no longer suspended or gross receipts for a quarter reach 80% of the prior year. The legislation does not expand on the meaning of "partially suspended."

For employers with more than 100 full-time equivalent employees, only wages paid when the employee was not providing services are eligible. For employers with 100 or fewer full-time equivalent employees, any wages when a business was fully or partially suspended or during the quarter of its gross receipts reduction are eligible. Wages also include properly allocable health plan expenses. The 100-employee threshold is determined under the Affordable Care Act (ACA) rules in Section 4980H for determining whether the shared responsibility payments apply.

The credit is allowed against payroll taxes and is not available for any wage payments related to the new requirement for paid leave and sick pay. Tax-exempts can claim the credit based on a full or partial suspension of a trade or business.

**Grant Thornton Insight:** This version of the employee retention credit is considerably different than other versions offered after natural disasters in the past. Those versions allowed a credit for paying employees whose principal work location was inoperable, regardless of whether the employee worked somewhere else. Under this credit, employers with more than 100 full-time equivalent employees will be required to establish that the employees provided no services for their wages while the business was suspended or gross receipts dropped. On the other hand, unlike prior versions, this provision does not disqualify wages from counting toward both this credit and the work opportunity tax credit. However, wages cannot count toward this credit and the Section 45S credit for paid family and medical leave. The credit is also not available for taxpayers taking small business interruption loans under the stimulus bill.

## Individual tax relief

### Tax credit rebates

The legislation creates a tax credit of \$1,200 for each filing adult who is not someone else's dependent and \$500 for each qualifying child. The credit begins to phase out at the adjusted gross income of \$75,000 (single), \$112,500 (head of household) or \$150,000 (joint), and it is fully refundable in the final bill. Treasury is instructed to issue rebates "as rapidly as possible" and can rely on either 2018 or 2019 returns.

### Early withdrawals and required minimum distributions

The legislation waives early withdrawal penalties for up to \$100,000 in COVID-19-related withdrawals from qualified retirement accounts. The taxpayer has the option of repaying the amount and incurring no tax. If the taxpayer does not repay it, the income is included ratably over three years beginning with the year of the withdrawal. Individuals may make eligible distributions if they are diagnosed with COVID-19, have a spouse or dependent diagnosed with COVID-19, or suffer adverse financial consequences from a quarantine, layoffs or reduced hours due to business issues or lack of childcare. The legislation separately raises the limit on borrowing from an account from \$50,000 to \$100,000 (with the 50% vested accrued benefit limit also doubled), so taxpayers could, in some circumstances, temporarily withdraw as much as \$200,000 from an account. The legislation would also suspend RMDs for Section 401(k), 403(b), and certain 457(b) plans.

### Charitable giving

The bill allows an above-the-line deduction for up to \$300 in charitable contributions of cash for taxpayers who do not itemize deductions in 2020. For taxpayers who do itemize, the bill removes the AGI limit on deductions for charitable contributions of cash in 2020. Contributions to donor-advised funds do not qualify.

### Healthcare change

The bill would permanently expand reimbursable expenses for HSAs and FSAs to again include over-the-counter medicine, reversing a change from ACA. Menstrual products would also be added to the list of reimbursable expenses. In addition, the bill would ease restrictions on direct primary care service and telehealth services with HSA high-deductible plans.

### Next steps

Lawmakers clearly prioritized immediate relief and cash flexibility. Most of the provisions are designed to provide quick access to cash, and taxpayers will have various options for claiming many of the benefits, including amending 2018 returns, using the 2019 return, or filing for a tentative refund. There may also be opportunities to enhance benefits by pairing the new incentives with other tax planning, especially regarding NOL carrybacks. Taxpayers should assess their options carefully before acting, as different filing positions can affect when a taxpayer receives a benefit and the ultimate size of the benefit.

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